

**NATIONAL
FEDERATION
OF FEDERAL
EMPLOYEES**

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SERVING FEDERAL EMPLOYEES AND THE NATION SINCE 1917

STATEMENT BY

THE NATIONAL FEDERATION OF FEDERAL EMPLOYEES

BEFORE

THE SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS

ON

THE CIVIL SERVICE PENSION REFORM ACT

S.1527

SEPTEMBER 9, 1985

Mr. Chairman and Subcommittee Members:

I appreciate the opportunity to testify today on S. 1527, a bill which Senator Stevens and Chairman Roth have introduced to establish a new retirement system for Federal employees hired after 1983. The National Federation of Federal Employees represents a substantial number of employees who are contributing to the current Civil Service Retirement System (CSRS) as well as employees who will eventually retire under the new supplemental system. We are therefore extremely concerned about the ability of the new retirement plan to provide a secure retirement for future Federal retirees.

S. 1527, the Civil Service Pension Reform Act of 1985, represents a good start toward designing a retirement system, and I commend the sponsors for your efforts to develop the plan before the January 1, 1986 deadline. The bill recognizes that a retirement annuity is the most important job benefit for both workers and management -- a consideration which is especially important in the Federal government. Civil service retirement is probably the only major benefit earned by civil servants which compares favorably with similar programs in the private sector. In fact, with pay rates and total compensation so low in comparison to the private sector, retirement is one of the few remaining incentives to stay in the Federal workforce. As such, it is the cornerstone of the Federal compensation system. It is the primary incentive for individuals to enter Government service and to pursue Government careers.

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Throughout the discussion of the new supplemental retirement plan, NFFE has urged Congress to develop a system which would provide a level of benefits comparable to the current program. It would be a disaster to create a new program that did not continue to protect the government's expertise and institutional knowledge. NFFE has also stressed that cost savings should not be the primary factor in establishing a new system -- the last thing we want is a cheap retirement plan. The modification of three of the most essential elements of the current CSRS, which S.1527 proposes, is therefore a cause of great concern. The benefits to which I refer are early-retirement, cost-of-living adjustments and the High-3 benefit calculation: all of which are valuable components of the current Federal annuity package.

The current Civil Service Retirement System permits an unreduced retirement benefit for an employee at age 55 with 30 years service, age 60 with 20 years service, and age 62 with 5 years service. The new bill, however, would permit an unreduced benefit only for employees at age 62 with at least 5 years service. Workers could choose to retire at age 55 with 30 years of service, but the benefit would be reduced by two percent for each year under age 62 an employee retires. Participants could also choose to retire at age 55 with less than 30 years of service but more than 10 years, with benefits reduced by five percent for each year under age 62.

The early retirement option, which has long been available to current Federal employees, is perhaps one of the most-valued retirement benefits civil servants believe they have under the current system. Changing this option would not only be unfair to post-1983 employees, but it would also be unnecessary. By penalizing these employees for retiring before age 62, S. 1527 would create two separate systems of age and service requirements. New employees should have the same retirement options as current Federal employees.

Despite charges that this benefit is too liberal, the current age and service requirements have resulted in an average Federal employee retirement age that is close to the average in private industry. According to the General Accounting Office, civil servants retire at an average age of 61.1 with 29 years of service; private sector employees retire on the average age of 61.8. And the cost to the retirement system is hardly significant. In fact, continuing the same age and service requirements under the new supplemental plan would add only .5 percent to the cost of the new system. In light of the value of the early retirement option for Federal employees, .5 percent is a small price to pay to retain highly qualified employees, and I urge the Committee to restore this option.

I am also concerned about the reduction in the cost-of-living adjustment (COLA) for retirees proposed by S. 1527. The current

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CSRS provides for a full COLA. The supplemental retirement bill, however, would reduce the annual COLA to the rate of the Consumer Price Index (CPI) minus two percentage points. This reduction violates the most fundamental principle of a staff retirement system - to protect retirees from a loss in the value of their benefit payments. On the basis of equity alone, the supplemental retirement plan should provide a full COLA in order to retain the current system's commitment to the future financial security of retirees.

Finally, the new supplemental retirement system would modify the recent method of calculating benefits based on the salary base. The salary base for calculating the retirement annuity is derived from the average of the three highest years of service. Under S. 1527, the salary base would be determined from an average of the five highest years, thus lowering an employee's salary base considerably. Combined with the reduction in the COLA and the penalties for retiring at age 55 or age 60, the change from High-3 to High-5 would severely reduce benefits. With pay rates and total compensation so low in comparison to the private sector, retirement is one of the few remaining incentives to stay in the Federal workforce. Should civil service retirement also fall below private sector standards, the Government would find it virtually impossible to recruit and retain talented employees.

These changes over the CSRS not only threaten future retirees (hired after 1983) whose benefits would be significantly reduced, they also set a dangerous precedent for the current system. Provisions such as these could easily put pressure on the current CSRS for similar changes. I therefore urge the Committee to consider carefully the damaging effect on both annuities and employee morale such reductions would have. The cost of restoring these benefits would surely be small in comparison to the resulting increased morale and productivity.

I would now like to address the thrift portion of the new supplemental retirement plan which, aside from social security coverage, is the most significant change from the current system. While the concept of a thrift plan has merit, there are inherent difficulties in both its application and administration. In addition, the plan does not give the employee significant control over the management of his or her account.

S. 1527 establishes a thrift plan into which employees may contribute up to 10 percent of their salary with a maximum employer matching contribution of 5 percent. (The contributions would not be included in gross income for tax purposes before the account is paid out.) Under the new plan, the employee/employer contributions would be absorbed into only three investment options: (1) a Government Securities Investment Fund which is invested in special issues

of the Treasury, (2) a Fixed Income Investment Fund which is invested in insurance contracts, certificates of deposit, or other instruments, and (3) a Common Stock Investment Fund which is invested in common stock issues included in a commonly recognized stock index. These accounts would be administered by a Thrift Investment Board with the assistance of a Civil Service Thrift Advisory Committee.

The thrift plan, as it is now envisioned, leaves me with four immediate concerns. They are: the effective management of potentially vast sums of money in the thrift plan and their impact on the economy; the creation of a new government entity with appointed individuals who more than likely do not have the necessary expertise to administer the thrift plan funds; the strong, economic power base such individuals would hold; and finally, the restriction of an employee's fundamental right to choose where his or her contributions should go.

As more and more employees join the Federal workforce and participate in the thrift plan, a huge sum of money will be available for investment. In fact, the fund will be the largest single employer-thrift plan in the world and as such will have a significant impact on the economy. As the funds accrue, they could increase to such monumental proportions as to be completely unwieldy and possibly, economically threatening. According to our estimations, the thrift

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plan could accumulate \$998,910,968,217.14, or \$1 trillion over a forty year period. Even the most conservative estimates show that approximately one half of a trillion dollars would be amassed.

Without a doubt, this vast sum of money could have a significant impact on the business world. While it is true that private pension funds now hold approximately \$1.3 trillion and absorb one hundred billion dollars a year, these funds are held by individual pension funds. There is no single board which decides how these private pension funds are invested. S. 1527, however, would create a board which would be making decisions controlling almost one trillion dollars. As you can imagine, the potential economic power the Civil Service Pension System thrift plan managers would have would be enormous. My concern lies in the ability to ensure adequate protection against financial manipulation by the thrift plan administrators. I am not yet confident that these protections can be made strong enough.

The size of the government entity required to actually administer the thrift plan would have to be enormous to properly manage and invest such a large fund. I do not believe that, as S. 1527 is currently written, either the investment board or advisory committee can adequately meet this responsibility. Not only would it be difficult to attract the high caliber employees needed to fulfill this mandate, but appointed individuals, with little or no investment experience would make the final decisions. I am not confident that the best decisions would be made.

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Finally the thrift plan fails to give employees adequate control over their thrift account. Although the thrift plan provides employees with vehicles by which to invest their funds, it takes away their independence to make such decisions for themselves. The plan, therefore, cannot be considered an adequate investment mechanism. I firmly believe that any new Federal thrift plan must enable, even encourage, employees to make their own investment decisions which will suit their individual needs. You would do a great injustice to civil servants by underestimating and limiting their ability to determine their own retirement investments. The Federal workforce is better educated and more professional than at any other time in its history. It is essential, then, that its employees should be given the right to control their own retirement future.

The Committee could grant this right by amending Title I of the Civil Service Pension Reform Act of 1985 to allow employees to designate where their funds will go. This approach would permit employees to designate the thrift retirement account of their choice provided the account satisfies requirements similar to those required for individual retirement accounts. This would eliminate the need for a new government entity that would have invested the monies into government established accounts. Since the contributions will be placed into individual thrift accounts, no Federal body would be necessary to make investment decisions. Authority to promulgate regulations to implement and manage the programs could be given to the Internal Revenue Service or another Federal agency.

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The employee could specify the amount to be deducted (by the employing agency) from the employee's paycheck. The employee and matching employer contributions could in turn be electronically transferred and deposited into a thrift plan account of the employee's choosing. Such designations could be changed, without restriction, at the employee's request. As provided by S. 1527, all contributions would be made on a tax-deferred basis and the employee would be charged no administrative fee.

The design of a retirement system that encompasses both a defined benefit, defined contribution and social security system is a formidable task. I must therefore commend both the Chairman and Senator Stevens for undertaking this task and for moving the new supplemental retirement system from discussion toward implementation. I hope the Committee will consider NFFE's concerns and suggestions and continue to work with us to develop a secure retirement system for future retirees.

That concludes my statement. I will be happy to answer any questions you may have.